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ABANDONED PROPERTY OF A PUBLIC SERVICE COMPANY AS DEPRECIATION.—A recent case throws much light on the power of the Interstate Commerce Commission under section 20 of the Interstate Commerce Act,<sup>1</sup> and upon the kindred subject of the proper valuation of public service companies for rate purposes. The plaintiff railway company, finding new grades essential, issued bonds, and with the proceeds constructed sections of new road in substitution for parts of the old road, this being a cheaper method than altering the old road. Regulations of the Commission allowed the company to credit its property accounts with only the difference between the full cost of the improvements and the value of the abandoned property as determined by its estimated replacement cost, and required this estimated value of the abandoned property to be charged as an operating expense. The Supreme Court<sup>2</sup> held such regulations within the power of the Commission, under section 20, and that the regulations made were not abusive of that power. *Kansas City Southern Ry. Co. v. United States*, 34 Sup. Ct. 125.

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<sup>1</sup> As amended in 1910. U. S. COMP. STAT. 1901, SUPPLEMENT 1911, p. 1304. The material parts of the section for the present purpose are: "Sec. 20. The Commission may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this Act, prescribe a period of time within which all common carriers subject to the provisions of this Act shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept. . . . The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act."

<sup>2</sup> On appeal from the United States Commerce Court. The plaintiff sought an injunction to restrain the enforcement of the regulations as applicable to its case.

That the Commission can enforce uniform accounting follows from a previous case holding the Interstate Commerce Act constitutional.<sup>3</sup> The company urged, however, that the statute conferred upon the Commission the power to control the "form," but not the "substance" of the accounts.<sup>4</sup> But the distinction seems unsupportable, since it is clear that to secure uniformity the Commission must be able to name the headings under which the various items shall be placed.

It is true that the placing of certain items under certain heads, as in the principal case, may temporarily force a reduction in dividends and so cause hardship seemingly out of proportion to the need of uniformity in accounting. But examination will show that in most cases the method of accounting ordered is simply a means used in carrying out some rate or other regulation, the results of which must be taken into account in considering whether the Commission's order is an abuse of its power.<sup>5</sup>

In the principal case the effect of the holding is that abandoned property cannot be treated as a property asset. Now since a public service company is only entitled to earn annually a sum sufficient to pay its operating expenses and a fair return<sup>6</sup> on the present value of the property used for the public,<sup>7</sup> the regulations in question will tend to decrease the sum on which the company may earn a fair return. It is true that on the question of exactly how that value is to be determined, the law is in a stage of development,<sup>8</sup> but clearly the value, as shown by the books,

<sup>3</sup> Interstate Commerce Commission *v.* Goodrich Transit Co., 224 U. S. 194, 32 Sup. Ct. 436.

<sup>4</sup> The argument was that the words in the statute "to prescribe the *forms* of any and all accounts" distinguished between form and substance, and enabled the Commission to say in what manner the accounts should be kept, but not what items should go into certain accounts.

<sup>5</sup> For if it is an abuse of power by the Commission, undoubtedly it will not stand. *Southern Pacific Co. v. Interstate Commerce Commission*, 219 U. S. 433, 31 Sup. Ct. 288.

<sup>6</sup> On the general problem of what is a fair return, see 2 WYMAN, PUBLIC SERVICE CORPORATIONS, ch. 33.

<sup>7</sup> See The Minnesota Rate Cases, 230 U. S. 352, 434, 33 Sup. Ct. 729, 754. For a time other theories, notably the original cost and the cost of reproduction theories, contended with the present value theory, but the latter may now fairly be regarded as the accepted doctrine in valuation for rate purposes. The Supreme Court adopted it in *Smyth v. Ames*, 169 U. S. 466, 546, 18 Sup. Ct. 418, 434, and state courts and commissions generally abide by it. For cases proceeding on the original cost and cost of reproduction theories, respectively, see *Brymer v. Butler Water Co.*, 179 Pa. 231, 36 Atl. 249; *Steenerson v. Great Northern Ry. Co.*, 69 Minn. 353, 72 N. W. 713. For a general discussion of the several theories and the various problems raised in the application of them, see 2 WYMAN, PUBLIC SERVICE CORPORATIONS, ch. 32.

It should always be remembered that valuation for rate purposes differs essentially from valuation for taxation, capitalization, and public purchase purposes, and that the present value theory was worked out in and especially applies to valuations for rate purposes. See, generally, WHITTEN, VALUATION OF PUBLIC SERVICE CORPORATIONS, ch. I.

<sup>8</sup> The following passage from *Smyth v. Ames*, 169 U. S. 466, 547, 18 Sup. Ct. 418, 434, names many factors that are worthy of consideration in determining present value. "In order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses, are all matters for consideration, and are to

of the property being used for the public must play an important part in the determination, both when the company itself fixes the rates and when the Commission adjusts them. Do the property assets as limited by the regulation make a proper basis for rate valuation? Valuations for rate purposes which omit the element of depreciation are held erroneous.<sup>9</sup> Depreciation is "lessened utility value caused by physical deterioration or lack of adaptation to function."<sup>10</sup> Abandoned property is obviously no longer adaptable to function. Therefore the regulations seem both justifiable and necessary. The company's argument that the cost of abandoned property is part of the "cost of progress," and should therefore be retained in the property accounts, runs counter to the whole "present value" theory followed by the Supreme Court.<sup>11</sup> A more plausible contention was that, had the improvements been made on the old line, the whole cost of the work could under the regulations have been added to the property accounts without deduction. In such a case, however, the company has withdrawn no property from public use, since the former construction still serves as a base for the new line, and hence as a matter of accounting the value of the old line need not be subtracted from the property accounts.<sup>12</sup>

The approval of the Commission's further requirement that the depreciation be charged against operating expenses, and not against surplus,<sup>13</sup> is not so noteworthy, because the court says that neither method would have been erroneous.<sup>14</sup> The charge against operating expenses, however, seems in this case more just. Each generation should pay the cost of progress made by the road in that generation. The abandonment of an uneconomic for an economic plant is manifestly a progress. The charge against operating expenses, by necessitating a temporary increase in rates, properly places the burden on the present generation.<sup>15</sup>

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be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property." Undoubtedly there are such other matters, notably depreciation. In two rather recent cases the court has not regarded all the factors laid down in this quotation, but has gone largely on cost of reproduction and depreciation. *Knoxville v. Knoxville Water Co.*, 212 U. S. 1, 29 Sup. Ct. 148; *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 29 Sup. Ct. 192. The cases illustrate the proposition that the relative weight to be given to the several factors enumerated in *Smyth v. Ames*, *supra*, depends on the facts of each case.

<sup>9</sup> *Knoxville v. Knoxville Water Co.*, *supra*; *The Minnesota Rate Cases*, *supra*.

<sup>10</sup> See WHITTEN, *VALUATION OF PUBLIC SERVICE CORPORATIONS*, 331.

<sup>11</sup> It would make the *actual cost* of the plant regardless of depreciation, and not its present value, the test for valuation purposes. If property is discarded, it is no longer used for the public, and therefore no return can be earned on it, even though the disallowance of such return results in a decrease or loss of dividends.

<sup>12</sup> It is believed, however, that in ascertaining present value for rate purposes, a deduction for depreciation would have to be made to cover the decreased value of the old line when used simply as a base or foundation for the new line with its changed grades. That is, it would not be correct to say that the present value of the line equals the cost of the old line plus the cost of the improvements.

<sup>13</sup> The profit and loss account.

<sup>14</sup> It should be noted here that the best practice is to have a depreciation fund, built up year by year, to cover just such items as this. See *Knoxville v. Knoxville Water Co.*, *supra*, p. 13; 2 WYMAN, *PUBLIC SERVICE CORPORATIONS*, § 1169.

<sup>15</sup> The justice of the order is made even plainer by the fact that a regulation of the Commission provides for a projection of the depreciation, if it is large, over the operating expenses of several years.